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IN THE

Supreme Court of the United States

October Term 1960

No. 732

WALGREEN CO., an Illinois Corporation,

Appellant,

vs.

COMMISSIONER OF TAXATION,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF MINNESOTA

JURISDICTIONAL STATEMENT

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STATEMENT AS TO JURISDICTION

Appellant appeals from the judgment of the Supreme Court of the State of Minnesota entered in this action on September 27, 1960, affirming the judgment of the District Court, Second Judicial District, County of Ramsey, State of Minnesota, and submits this statement in support of its contention that the Supreme Court of the United States has jurisdiction of this appeal and that a substantial question is presented.

OPINION BELOW

The opinion of the state Supreme Court in this action has not been officially reported as yet in the Minnesota Reports. It is reported in 104 N.W. 2d 714. Copies of the opinion of the Minnesota State Supreme Court and of its judgment are attached hereto as Appendix A. Attached hereto as

Appendix B are copies of the District Court's (Trial Court's) findings of fact, conclusions of law and order for judgment dated September 30, 1958; order for amended findings of fact dated December 10, 1958; and judgment dated February 11, 1959. They have not been reported.

JURISDICTION

This suit was brought by appellant under Minn. Stat. 290.50, Subd. 2 (1949) in the District Court, Second Judicial District, County of Ramsey, State of Minnesota against the Commissioner of Taxation to recover certain additional income (privilege) taxes assessed against appellant amounting to $13,026.73 and interest thereon amounting to $2,471.70. The judgment from which this appeal is taken is the judgment of the State Supreme Court entered on September 27, 1960 following the decision of the Court rendered on August 5, 1960. A timely petition for reargument was filed by appellant on August 19, 1960 and was denied by the State Supreme Court on September 27, 1960. Notice of Appeal was filed by appellant in the State Supreme Court on December 22, 1960.

The jurisdiction of the Supreme Court of the United States to review the decision and judgment of the State Supreme Court by direct appeal is conferred by Title 28, United States Code, Sections 1257 (2) and 2101 (c). The following decisions sustain the jurisdiction of this Court to review the judgment on direct appeal in this case: *Dahnke-Walker Co. v. Bondurant* 257 U.S. 282, *Fiske v. Kansas*, 274 U.S. 380 and *Poulos v. New Hampshire*, 345 U.S. 395. In *Fiske v. Kansas* this Court said at page 385:

> "A decision of a State Court applying and enforcing a state statute of general scope against a particular trans-

action as to which there was a distinct and timely insistence that, if so applied, the statute was void under the Federal Constitution, necessarily affirms the validity of the statute as so applied, and the judgment is, therefore, reviewable by writ of error under Section 237 of the Judicial Code."

STATUTE INVOLVED

The statute involved in this action is Section 290.19 of Minnesota Statutes (1949). It is set forth in Appendix C hereto.

QUESTIONS PRESENTED

The following questions are presented by this appeal:

1. Whether appellant has the right to show that application by appellee of the multiple-factor formula as the means of assigning a portion of appellant's taxable income to Minnesota violates the Due Process Clause or the Interstate Commerce Clause of the U. S. Constitution, or both, because it reaches income which is not attributable to appellant's activities in Minnesota.

2. Whether the multiple-factor formula used by appellee and in effect made mandatory upon this appellant by appellee and by the Supreme Court of Minnesota violates the Due Process Clause or the Interstate Commerce Clause of the U. S. Constitution, or both, where it is shown that said formula apportions more taxable income to Minnesota than is attributable to Minnesota.

STATEMENT OF CASE

The State of Minnesota imposes a corporate privilege or franchise tax on domestic and foreign corporations, measured by the corporation's taxable net income for the taxable year for which the tax is imposed. Minn. Stat. Section 290.02 (1949). This is a suit for refund of a portion of the franchise taxes paid by appellant for its fiscal periods ending on September 30, 1950, September 30, 1951, September 30, 1952 and September 30, 1953. The issue between the parties arises over the proper method to be used in arriving at the taxable net income forming the basis of the privilege or franchise tax.

Appellant filed returns calculating the amount of its taxable net income by the use of what is commonly termed the "separate or segregated accounting method." Appellee has denied the use of this method to appellant and has substituted for it a method commonly referred to as the "three-factor formula" or "multiple-factor formula" or simply "formula."

Application of the appellee's method resulted in appellant's owing additional taxes for each of the four taxable periods involved in this controversy. Appellant paid the additional taxes and began a suit for refund of the amounts paid, together with interest, in District Court, Second Judicial District, County of Ramsey, State of Minnesota. Judgment was entered denying appellant's claims for refund and on February 3, 1959 appellant appealed to the Supreme Court of Minnesota. That Court affirmed the judgment of the lower Court on September 27, 1960.

THE NATURE OF APPELLANT'S ORGANIZATION AND BUSINESS ACTIVITIES IN GENERAL

Appellant operates retail drug stores in the states of Minnesota, Colorado, Illinois, Indiana, Michigan, Iowa, Nebraska, South Dakota and Wyoming. Its principal offices are in Chicago, Illinois and it has branch offices in Denver, Clorado and Minneapolis, Minnesota. The average number of all stores operated by it during the four years involved was 205. The average number in Minnesota during each of the four years was 14.

Store operations are divided into districts throughout the states in which appellant operates. The stores in Minnesota and one store in Eau Claire, Wisconsin and one store in Aberdeen, South Dakota comprise a district. The district manager for this district resided in Minneapolis, Minnesota. Each store in this district was supervised by a store manager who was responsible to the district manager. All district managers were responsible to the general store management at Chicago, Illinois.

The executive offices of appellant are located in Chicago and general management of all stores is directed from there. Central personnel, advertising, purchasing, accounting and research departments are maintained at the home office.

APPELLANT'S SEPARATE ACCOUNTING METHOD

Appellant determined and reported to the State of Minnesota its taxable income by means of the separate accounting method. This method is permitted by Minn. Stat. Sec. 290.19 Subd. 1 (2) (b) under certain conditions.

The amount of gross income earned by appellant in Minnesota is derived chiefly from its drug store operations in Minnesota, and incidentally from its ice cream plant in Minneapolis, Minnesota and its Minneapolis warehouse.

1. APPELLANT'S STORE OPERATIONS IN MINNESOTA

The amount of taxable net income for each store can be determined from the individual profit and loss statement maintained for each store. The starting point of the profit and loss statement for each store is the gross sales for the store. From gross sales a deduction is taken for the cost of goods sold. The resulting figure is called gross profit. From gross profit is deducted the expenses of the store. These expenses are either direct or indirect expenses.

The direct expenses are those incurred for the operation of the store in the area in which it is located. Rental paid for a Minnesota store and salaries and wages paid to Minnesota employees illustrate the nature of these expenses. Indirect expenses are the executive and administrative expenses incurred at the Chicago home office. Examples of these expenses are the cost for the advertising, accounting and research departments at the home office. The amount of home office expense assignable to Minnesota operations is determined by comparing the sales of all Minnesota stores to total

sales of all drug stores in the Walgreen chain. The ratio thus obtained is multiplied against the total home office expense to determine the amount allocable to Minnesota. The amount of home office expense deducted on the Minnesota return varied from $125,000 to $135,000 for each of the four years in issue. However, it was shown that disregarding the home office expense, the facts showed less Minnesota income than was produced by appellee's method—see below, page 17.

2. APPELLANT'S ICE-CREAM PLANT AND WAREHOUSE OPERATIONS

Appellant maintained a plant in Minneapolis, Minnesota at which it froze prepared ingredients into ice cream and packaged the ice cream. The only store outside of Minnesota to which ice cream was sold was the store in Aberdeen, South Dakota. The entire proceeds of all sales of ice cream from the Minneapolis plant, including the sales to the Aberdeen store, were included by appellant in its Minnesota income on its tax return.

Appellant maintained a warehouse in Minneapolis, Minnesota from which company stores could purchase items for sale in their stores. To each item sold from the warehouse there was added an amount to cover the cost of operating the warehouse. During the years in question this amount varied from 4 to 4½% of the cost of each article sold from the warehouse. This percentage was determined by using the previous year's experience and then forecasting what charge would be necessary to cover the operating expenses of the warehouse for the current year. The entire profit or loss of the Minneapolis warehouse was included by appellant in its Minnesota income on its tax return.

The appellee raised issues of (a) whether the ice cream plant made appellant a "manufacturer", thus removing its right to the separate accounting tax treatment; and (b) whether the allocation of warehouse costs and certain other costs (advertising and quantity discounts) were correct. The Court below, however, did not decide either of these issues. Instead, the Court below faced squarely the question of taxing of non-Minnesota income, and resolved it against appellant. In doing so, it assumed that the question was whether the separate accounting method of appellant showed that the formula method of appellee was wrong. That was not the issue (see below, page 17).

APPELLEE'S FORMULA METHOD

Appellee contends that appellant's taxable income assignable to Minnesota should be determined under what is termed the "three-factor formula" or "multiple factor formula" or simply "formula." The formula involves the arithmetical average of the three factors of sales, property and payrolls. Under this formula, three ratios are determined: (1) The ratio of sales made by, through or from offices in Minnesota to total sales; (2) the ratio of tangible property owned or used in Minnesota to total tangible property; and (3) the ratio of payroll paid or incurred in Minnesota to total payroll paid or incurred. The average of these three ratios is then obtained and this average is applied against total net income (with the exception of certain items, called "nonapportionable items" which are not here at issue) to determine the portion of total net income assignable to Minnesota.

The formula is not unique to Minnesota and is commonly found in the statutory provisions of other states imposing an income tax.

HOW THE FEDERAL QUESTION IS PRESENTED

The federal question involved herein was first raised by appellant in its pleadings. The amended complaint included the following paragraph:

> "By reason of the said actions, and failure to act, of the defendant and his predecessor in office, the plaintiff will be deprived of property in violation of the due process clause of the United States Constitution and the due process clause of the Constitution of the State of Minnesota, and in violation of the commerce clause of the United States Constitution, by taxing non-Minnesota income of plaintiff."

The Minnesota Supreme Court, in its opinion, stated (Appendix A, page 31):

> "On appeal plaintiff contends that (1) by its application of the three factor formula defendant is taxing income not attributable to plaintiff's activities in Minnesota in contravention of the due process clause of U.S. Const. Amend. XIV; * * *"

Where it appears from the opinion of the State Court of last resort that a state statute was drawn in question, as repugnant to the United States Constitution, and that the decision of the Court was in favor of its validity, this Court has jurisdiction on appeal. *Charleston Federal Savings & Loan Association v. Alderson*, 324 U.S. 182.

THE QUESTIONS ARE SUBSTANTIAL

Sec. 290.02 of Minn. Stat. (1949) imposes an annual tax upon domestic corporations for the privilege of existing as a corporation and upon foreign corporations for the grant of the privilege of transacting or for the actual transaction of a local business within Minnesota in corporate form. During each of the four years involved in this suit, this section read as follows:

> "Imposition of Privilege Tax on Corporations; Measurement. An annual tax is hereby imposed upon every domestic corporation, except those included within Section 290.03, for the privilege of existing as a corporation during any part of its taxable year, and upon every foreign corporation, except those included within Section 290.03, for the grant to it of the privilege of transacting or for the actual transaction by it of any local business within this state during any part of its taxable year, in corporate or organized form.
>
> "The tax so imposed shall be measured by such corporations' taxable net income for the taxable year for which the tax is imposed, and computed in the manner and at the rates provided in this chapter."

The corporations referred to in Sec. 290.03 are corporations engaged exclusively in interstate or foreign commerce. Appellant is not such a corporation and is therefore taxable under Sec. 290.02.

The manner of computing taxable net income for the years in this suit is given in Sec. 290.19, Subd. 1 (1) thereof requires use of the three-factor formula where the business of the taxpayer consists of the manufacture in Minnesota or within and without Minnesota of personal property and the sale of such property within and without Minnesota.

Subd. 1 (2)(a) requires use of the sales factor in all other cases. However, Subd. 1 (2)(b) permits use of the three-factor formula or separate accounting where the sales factor will not properly reflect taxable net income and where either the formula or separate accounting will. Both parties agree that the sales factor does not properly reflect net income in this case.

The Minnesota Supreme Court in the instant case held that the separate accounting method is "inherently incapable" of accurately allocating income (Appendix A, page 36), and upheld appellee's application of his formula. This holding sharply focuses the constitutional questions involved in this appeal.

This case differs strongly from other cases where a multiple-factor formula was upheld. Here, unlike those cases, a clear showing was made of taxation of income from outside the taxing state, and this showing was relied on below.

I

APPELLANT HAS THE RIGHT TO SHOW THAT USE BY THE STATE TAXING AUTHORITY OF THE MULTIPLE-FACTOR FORMULA AS A MEANS OF ASSIGNING A PORTION OF THE CORPORATION'S TAXABLE INCOME VIOLATES THE DUE PROCESS CLAUSE AND THE INTERSTATE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION BECAUSE IT REACHES INCOME WHICH IS NOT EARNED WITHIN THE STATE.

The Due Process Question

Appellant contends that it can identify with exactness all items of gross income assignable to Minnesota and further that it can identify all deductions from its gross income to arrive at its Minnesota taxable net income. Does it have the the right to try to show by this method that income is being taxed in violation of the due process clause? In the case of *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, this Court considered, and held unconstitutional, the application of a single factor property formula to a unitary business. It said at 283 U.S., page 134:

> "* * * When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a state has applied a method which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction."

This is exactly the position which appellant urges here, i.e., that it has the right to show that the method used by appellee reaches profits which are in no just sense attributable to transactions within its jurisdiction. It may be difficult for a unitary corporation to make this showing, but this does not alter its right to try to do so.

The fact that the tax imposed under the Minnesota Statute is a privilege or franchise tax and not a direct income tax has no legitimate bearing upon the constitutional questions raised by this appeal. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120.

The Interstate Commerce Question

This court, in its recent decision in *Northwestern States Portland Cement Company v. State of Minnesota*, 358 U.S. 450, 458, reiterated the long established doctrine that the commerce clause gives exclusive power to the Congress to regulate interstate commerce and its failure to act on the subject in the area of taxation nevertheless requires that interstate commerce shall be free from any direct restrictions or impositions by the State. It was further said that in keeping therewith a state may not impose a tax which discriminates against interstate commerce by subjecting interstate commerce to the burden of "multiple taxation" because the States, under the Commerce Clause, are not allowed "one single-tax worth of direct interference with the free flow of commerce". *Ibid.* It is a necessary incident to these principles that a taxpayer have the right to try to show that a tax operates so as to place a burden upon interstate commerce. *Northwestern States Portland Cement Company v. State of Minnesota*, supra; *Central Greyhound Lines v. Mealey*, 334 U.S. 653. This appears so plain as to require no citation of

authority. And yet it has been appellee's position throughout this litigation that appellant does not have this right. Appellee has always maintained that appellant must use the formula regardless of whether appellant can show that the formula violates both the Due Process Clause and the Commerce Clause of the United States Constitution. The Minnesota supreme court, by approving appellee's determination to apply the formula, has accepted appellee's position.

To deny a taxpayer the right to try to show that income is being reached in violation of its constitutional rights will leave it powerless to question application of the formula in states which, like Minnesota, have a three-factor formula. Appellant operates in nine states. It is possible that it, or any taxpayer, might (although with difficulty) be able to show beyond doubt that income it earned in other states was being taxed in a different state.

Assuming a taxpayer could produce the evidence necessary, it apparently would be of no use, under the following language of the Minnesota Supreme Court in the instant case (Appendix A, page 33):

> "* * * and the fact that conditions or costs may vary from state to state in the operation of a unitary business does not affect the propriety of the application of the formula, since the mutual dependence of the inter-related activities and furtherance of the entire business sustains the apportionment process * * *"

If a unitary business operates at an overall profit, use of the formula will always attribute a portion of the profit to each state in which operations are conducted regardless of the conditions in each state. Appellant submits a taxpayer should have the right to show that the profit attributed to the taxing state must in fact include profits earned elsewhere,

and it further submits that its evidence did in fact make this showing.

Appellant does not argue that the formula is inherently unconstitutional but that it was unconstitutionally applied in this case. Its position is that appellant can isolate all items of gross income and deductions therefrom and that the resulting net income is all that can be reached as the basis of the tax. This position is not analyzed by the Minnesota Supreme Court. Nowhere is it shown to be incorrect. Rather the Court enunciates the broad principle that separate accounting is a defective measure for all unitary businesses. This rule goes too far. Each case should be tested by the facts it presents.

The opinion of the Minnesota Supreme Court in this case, if allowed to stand, will create uncertainty in what already is a very complex area of law.[1] At one point in its opinion (Appendix A, page 33), the Minnesota Court states that "The taxpayer's burden is not satisfied by proof that separate accounting allocates less income to the state," a principle which appellant fully acqnowledged to the Court, and further "It must establish that application of the three-

[1]There are at least 35 states, The District of Columbia, and at least 8 cities taxing business income, including earnings derived from interstate commerce where there is local business activity. No two states have exactly the same formula for apportioning the amount of income attributable to local activities within the state. The committee understands that the formulas currently in use are complex, that even within the formulas the meaning of the basic words are inexact; and that for example, many of the 35 income states used a different definition to cover the term "sale" . . .

* * * * *

The duplication and, indeed, even the triplication in the field of income taxation, requires that prompt attention be given to the dangers inherent in the widespread exploitation of tax sources among the governmental levels. S. Rept. No. 658, 86th Cong., 1st Sess. (1959), pp. 3 and 5.

factor formula results in a grossly inequitable allocation of such income." Apparently a taxpayer who could show a "grossly inequitable" allocation is foreclosed from doing so because its separate accounting method is "inherently incapable" of allocating income. (Appendix A, page 36). Contrary to the statement of the Minnesota Supreme Court, appellant has found no case holding separate accounting as a matter of law to be "inherently incapable" of accurately allocating income.

The Minnesota apportionment statute does not deny use of separate accounting to a unitary business. Appendix C. Not even the appellee's interpretative regulations go this far. Appendix D. Appendix E contains a list of the income tax laws of 22 states which contain provisions similar to the Minnesota law in regard to separate accounting. Despite the plain and unambiguous provisions of the Minnesota law and of the laws in the states listed in Appendix E, the Minnesota Supreme Court now appears to hold separate accounting represents an "inherently incapable" measure. Appellant submits there is no authority in support of this holding and that it is squarely at variance with the principles enunciated by this Court in *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123. The holding creates serious doubts as to the meaning of the statutory provisions which permit separate accounting and will create uncertainty in the minds of counsel who must advise literally thousands of corporations of their responsibilities under various state revenue laws. For these reasons, appellant submits it should be reviewed by this Court.

Appellant also respectfully submits that an order noting jurisdiction and affirming the Court below *per curiam* on the basis of previously decided cases would fail to meet the novel fact situation and the far-reaching pronouncement of the Court below.

II

THE FORMULA USED BY APPELLEE VIOLATES THE DUE PROCESS CLAUSE AND THE INTERSTATE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION BECAUSE IT APPORTIONS MORE TAXABLE NET INCOME TO MINNESOTA THAN WAS THE AMOUNT CONCLUSIVELY SHOWN TO HAVE BEEN EARNED IN MINNESOTA.

Appellant showed that for two of the years involved the appellee's formula apportions more income to Minnesota than was earned, by identifying all items of gross income assignable to Minnesota and subtracting therefrom *only the direct* deductions incurred in Minnesota—and ignoring all expense incurred outside the state. A similar showing was made for the four years in question as a whole. Any income in addition to that determined by deducting direct expenses from Minnesota gross income therefore *must have been "imported"* from activities of appellant outside of Minnesota, and taxation of it is therefore unconstitutional. *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123.

We start with the proposition that the maximum amount of revenue appellee can reach for tax purposes is the gross sales from appellant's activities in Minnesota. All sales from appellant's stores in Minnesota, its warehouse in Minnesota, and its Minnesota ice cream plant have been included in its gross sales figure for each of the four years in issue. Appellee has never shown where these gross sales figures allocate to Minnesota anything less than the maximum figure which Minnesota is entitled to reach under its income tax law. It

would appear obvious that appellee cannot tax a part of the gross revenues from the stores in other states.

The cost of goods sold was deducted from gross sales and to the resulting figure items of other, incidental, income (the amounts of which are not disputed) were added. From this resulting figure, specific expense deductions of $1,500,000 to $1,700,000 were taken on the returns for the years involved. Those deductions may be broken down into direct deductions and indirect deductions. Direct deductions are those incurred completely in Minnesota. Rents and utilities paid for Minnesota stores, and salaries paid to employees in the Minnesota stores are illustrations of direct costs or expenses. The Minnesota Supreme Court said in reference to these expenses "All such expenses were allowed by defendant as proper." (Appendix A, page 28).

Indirect expenses are that portion of the general and administrative expenses of the home office which were allocated to Minnesota. In each of the four years in controversy the deduction claimed by appellant on its Minnesota return for indirect expenses did not exceed $135,000 and averaged $130,000. (This testimony was not disputed.)

Appellant showed that for each of its fiscal years ending in 1952 and 1953 the formula allocated over $40,000 more income to Minnesota than was determined by the method of deducting direct expenses only. This showing was not controverted by appellee and was accepted by the Minnesota Supreme Court. (Appendix A, page 29). Thus, for each of these two years the entire amount of home office expense, which averaged approximately $130,000 in either year, could be added back to income and still result in less net income than does the formula. For all four years, the sum of $130,000 for each year could be added back, or a total of

$520,000 (being *all* of the indirect expense), and the total net income for the four years *would still be less* than that under the formula. A tabulation showing this is as follows:

Fiscal Year Ending	Minnesota Net Income, Separate Accounting Method	Minnesota Net Income, Separate Accounting Method, Disallowing Outside Expense	Minnesota Net Income, 3-Factor Formula
Sept. 30, 1950	($14,657.46) loss	$115,342.54	$ 98,265.55
Sept. 30, 1951	47,542.45	177,542.45	122,550.53
Sept. 30, 1952	(63,803.79) loss	66,196.21	115,194.26
Sept. 30, 1953	(64,802.09) loss	65,197.91	113,823.04
Total	($95,720.89) loss	$424,279.11	$449,833.38

This tabulation was set forth in the opinion of the Minnesota Supreme Court (Appendix A, page 29), and then ignored. The Court below simply failed to meet the fact that this tabulation shows that non-Minnesota income must be taxed by Minnesota under the formula.

The important point of this tabulation is that if one deducts from appellant's gross income *only* those deductions which are conceded to be proper deductions, i.e., the direct deductions incurred solely in Minnesota, the amount of resulting income for two of the years in question, and for the four years as a group, is still less than that determined under appellee's formula. Stated in another manner, appellant can identify the maximum amount of gross income assignable to Minnesota and can deduct therefrom less than all of the expenses which it concededly is entitled to take (that is, can deduct only direct expenses) and it still arrives at less net income for the years 1952 and 1953, and for the four years as a group, than the appellee's formula. *This proves conclusively that appellee is taxing a part of appel-*

lant's net income which appellant earned outside of Minnesota, and that its use of the formula is therefore unconstitutional. Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123; *Michigan-Wisconsin Pipe Line Co. v. Calvert,* 347 U.S. 157; *Central Greyhound Lines v. Mealey,* 334 U.S. 653. This is the inescapable logical consequence of attributing more income to Minnesota than is found after identifying all items of gross income and deducting only expenses incurred solely in Minnesota. Appellee has not met this argument, nor did the Court below. Nor could they.

The Minnesota Supreme Court yielded to the temptation to generalize about three-factor formulas and their constitutionality, without discussing the particular facts of this case (after having set them out at the beginning of the opinion). The key portions of the opinion are very brief, reading as follows (Appendix A, pages 33, 34, 35, and 36):

> * * * "The taxpayer's burden is not satisfied by proof that separate accounting allocates less income to the state.
>
> "* * * plaintiff must establish that * * * application of the 3-factor formula under §290.19, subd. 1(2)(b), has resulted in taxing such a substantial part of its income not attributable to Minnesota as to make the allocation grossly inequitable and invalid under the due-process clause of U.S. Const. Amend. XIV. On the other hand, if the evidence fairly supports the finding that application of the 3-factor formula has resulted in a reasonable reflection of its net income fairly apportionable to Minnesota, then even though this method may not have produced the most accurate or precise results, we have no choice but to approve it.
>
> "Under the principle established in Butler Bros. v. McColgan, 315 U.S. 501, 62 S. Ct. 701, 86 L. Ed. 991, * * * we are of the opinion that the commissioner's determination to apply the 3-factor formula should be

approved. While plaintiff's separate accounting method for the years in question has disclosed substantially less net income attributable to Minnesota than does application of the 3-factor formula, this is not a vital factor in determining whether the latter procedure has resulted in a fair reflection of plaintiff's net income taxable in Minnesota. Thus in Butler Bros. v. McColgan, *supra*, under the taxpayer's separate accounting method, a loss of $82,851 in California was indicated, while application of the 3-factor formula determined that $93,551.52 of the taxpayer's net income was apportionable to California—a difference of $176,402.52 for the year involved. In sustaining application of the 3-factor formula, the United States Supreme Court disregarded this as controlling on the theory that separate accounting practices vary according to the problem at hand and that though useful as a business aid they may not fit requirements when a state seeks to tax values created by business within its borders.

"* * * Basically, approval of the application of the 3-factor formula rests upon a conclusion expressed in most of the cited cases that in multistate unitary operations the separate accounting method is inherently incapable of accurately allocating income. Based upon the authorities cited and for the reasons expressed, we must uphold the commissioner's election to apply the 3-factor formula here."

It is apparent from this opinion that the Court relied heavily on *Butler Bros. v. McColgan*, 315 U.S. 501, and for that reason perhaps a brief discussion of that case is in order. In that case as in this, the taxpayer's separate accounting method produced losses in years in which the state's multiple-factor formula produced net income. What the taxpayer did not demonstrate (or at least the opinion of this Court does not advert to such a demonstration) was that the state was taxing income earned elsewhere. This Court said (315

U.S. at pages 507 and 508) that a separate accounting system might be useful as a business aid but did not fit the requirements of state taxation, and added "The results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here." In this case, this appellant is not asserting the correctness of its separate accounting system nor relying on it to impeach the validity of Minnesota's formula. It is instead relying on facts shown by taking gross income and subtracting from it direct Minnesota expenses to impeach the validity and propriety of Minnesota's formula. Those facts impeach the validity of the formula because they show that the formula is *in this case* resulting in taxing non-Minnesota income. This Court in *Butler Brothers* (at 315 U.S., page 507) stated that "one who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed." Appellant here has carried that burden. Its evidence is "clear and cogent," and is different from and more than the evidence shown by the taxpayer in the *Butler Brothers* case.

Appellant has never argued that the formula should not be used simply because separate accounting produces less net income and therefore a smaller tax. It does argue that it has shown conclusively that the formula imports into Minnesota income which was earned in other states. This is the crux of appellant's argument. Because of the importance of this issue to tax administrators having laws similar to the Minnesota law and to the great number of multi-state corporations subject to these laws, appellant respectfully submits that this issue should be considered by this Court.

SUMMARY AND CONCLUSION

Appellant submits:

1. It has the right to show that use by the Minnesota taxing authority of a multiple-factor formula resulted in reaching income earned outside of Minnesota by appellant, thereby violating the Due Process clause and the Interstate Commerce Clause of the United States Constitution.

2. Appellant has shown that the application by appellee of his multiple-factor formula in this case did result in the taxing of income earned by appellant outside of Minnesota. This is demonstrated in an inescapable way in this case by the fact that if all disputed or disputable deductions (being the indirect expenses incurred at the home office and apportioned to Minnesota) are entirely eliminated, nonetheless the net income is less than that asserted by appellee. The Court below indicated its disregard for this fact by its holding that the method of reporting income used by the appellant on its return (the so-called separate accounting method) was "inherently incapable" of determining correct income.

This misses the point. The question is *not* whether the method proposed by appellant is correct, but whether the method applied by appellee unconstitutionally taxes non-Minnesota income.

3. The question is important and should be decided only after appellant has been heard and full argument presented.

Respectfully submitted,

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DOHERTY, RUMBLE & BUTLER
Of Counsel

APPENDIX A

No. 28 Ramsey County

Thomas Gallagher, J. Took no part, Loevinger, J.

Walgreen Co.,

37798

Appellant,

vs.

Commissioner of Taxation,

Respondent.

Endorsed. Filed August 5, 1960.

Mae Sherman, Clerk, Minnesota Supreme Court.

SYLLABUS

1. Plaintiff, a multistate unitary business corporation with substantial operations in Minnesota, is subject to provisions of M.S.A. 1949, §290.19, subd. 1; in determining portion of its net income attributable to Minnesota. If a unitary business consists of the manufacture in Minnesota of products for sale within and without the state, provisions of §290.19, subd. 1(1)(a, b, c), are applicable. If not so engaged, under §290.19, subd. 1(2)(b), same formula may be applied in discretion of commissioner of taxation if it results in fair reflection of taxpayer's net income attributable to Minnesota, provided §290.19, subd. 1(2)(a), does not properly reflect such income.

2. The 3-factor formula for ascertaining apportionable net income prescribed in §290.19 has been upheld in numerous decisions as against separate accounting method even where

latter has attributed a much lower or in fact no taxable income to taxing state.

3. Even though application of 3-factor formula may result in overlapping of net income as between states, this does not render its application invalid, since it is recognized that in operation of unitary business interrelated activities engaged in in all states in which it operates contribute to profitable operations of business as a whole. Where taxpayer challenges application of 3-factor formula, burden rests upon him to show that its application has resulted in grossly inequitable assignment of net income to taxing state.

4. Under §290.19, subd. 1(2)(b), which does not relate to business of manufacturing, commissioner has discretion in determining whether application of 3-factor formula more fairly reflects net income of unitary business attributable to Minnesota than does separate accounting method provided for therein. To upset commissioner's decision, burden rests upon taxpayer to establish that choice of 3-factor formula has resulted in taxation of such a substantial part of its income not attributable to Minnesota as to make allocation determined under 3-factor formula so grossly inequitable as to be invalid under due-process clause of U.S. Const. Amend. XIV.

5. Under foregoing principles and authorities adhered to in Western Auto Supply Co. v. Commr. of Taxation,' 245 Minn. 346, 71 N.W. (2d) 797, *held* commissioner's choice of 3-factor-formula method of allocation was not abuse of discretion notwithstanding that taxpayer's separate accounting method indicated wide divergence in results arrived at as between the two methods. That 3-factor formula apportioned taxable income to Minnesota substantially in excess of that determined under taxpayer's separate accounting method

does not render result invalid, since separate accounting method is usually regarded as inherently incapable of accurately allocating income.

Affirmed.

OPINION

THOMAS GALLAGHER, Justice.

Action by Walgreen Company, an Illinois corporation, against Commissioner of Taxation of the State of Minnesota, to recover $15,498.43 plus interest for income taxes claimed to have been illegally assessed against and collected from plaintiff for the fiscal years ending September 30, 1950; September 30, 1951; September 30, 1952; and September 30, 1953.

Plaintiff contends that, in determining that part of plaintiff's net income attributable to Minnesota for income tax purposes, the commissioner arbitrarily used the 3-factor formula prescribed in M.S.A. 1949, §290.19, subd. 1(a) (a, b, c), even though the separate or segregated accounting method used by plaintiff and prescribed in §290.19, subd. 1(2)(b), more accurately disclosed such income; and that in consequence the income tax claimed for the years described was based upon income not attributable to or earned in Minnesota. The commissioner contends that the evidence sustains a finding that plaintiff was engaged in manufacturing in Minnesota during such years and that accordingly under §290.19, subd. 1(1)(a, b, c), the use of the 3-factor formula was compelled; and further that even though it be determined that plaintiff was not engaged in the manufacturing business the evidence sustains the trial court's finding that the 3-factor formula reasonably reflected that part of

plaintiff's net income attributable to Minnesota, and hence under §290.19, subd. 1(2)(b), was applicable. The commissioner's determination was affirmed on appeal to the district court which ordered judgment in his favor. The present appeal is from such judgment.

Plaintiff's principal office during the years involved was in Chicago, Illinos. It operated retail drugstores in Minnesota and eight other states. Fourteen of such stores were within Minnesota and 191 of them were outside this state. In addition, it operated a substantial number of Minnesota agencies under franchises which authorized local retail drugstore owners to use its name and to purchase their stocks of merchandise from it. Each retail drugstore had a local manager and was supervised by a district manager. Plaintiff maintained warehouses in Chicago and Minneapolis. A large portion of the merchandise bought for all of its Minnesota stores and agencies came from its Minneapolis warehouse. Accounting for all stores was centralized in the executive offices in Chicago. The district managers and store managers were trained under the supervision of the central office in Chicago.

A part of plaintiff's business in Minnesota then consisted of the manufacture and sale of ice cream. The gross annual sales from this source in Minnesota were approximately $200,000, of which $4,000 came from sales outside the state. Plaintiff's gross Minnesota sales of all other products, none of which it manufactured here, were in excess of $4,000,000 annually.

Under its separate accounting method for the years in question, all sales from its Minnesota stores, its warehouse in Minneapolis, and its ice-cream plant there were included in its gross sales figure. Thereafter the cost of goods sold

was deducted from gross sales, and to the resulting figure, items of other income not in dispute were added. From this result expenses and other deductible items were subtracted. These deductions amounted to approximately $1,500,000 for the fiscal year ending 1950; $1,600,000 for the fiscal year ending 1951; $1,700,000 for the fiscal year ending 1952; and $1,600,000 for the fiscal year ending 1953. These deductions fell into what plaintiff designated as direct and indirect expenses of doing business in Minnesota. The direct deductions were those incurred here including rent, salaries to Minnesota employees, advertising in Minnesota newspapers, and like items. All such expenses were allowed by defendant as proper. As indirect expenses allocated to Minnesota, plaintiff deducted approximately $130,000 for each of the four years in question. Such deductions related to the general and administrative expenses incurred in the operation of the central office in Chicago.

Plaintiff submitted a compilation which indicated certain differences in net income attributable to Minnesota as determined under its separate accounting system and as determined under the 3-factor formula applied by the commissioner as follows:

Fiscal Year Ending	National Net Income	Minnesota Net Income, Separate Accounting Method	Minnesota Net Income, 3-Factor Formula
Sept. 30, 1950	$4,683,825	($14,657.46) loss	$ 98,265.53
Sept. 30, 1951	3,226,669	47,542.45	122,550.53
Sept. 30, 1952	2,815,762	(63,803.79) loss	115,194.26
Sept. 30, 1953	2,527,707	(64,802.09) loss	113,823.04

During these same years, exhibits submitted indicated that national sales (after cost of goods sold) and Minnesota sales (after cost of goods sold) compared as follows:

	National	Minnesota
1950	$28,685,125	$1,539,355
1951	29,941,617	1,664,580
1952	28,571,655	1,640,968
1953	28,400,530	1,544,168

Plaintiff directs attention to the fact that if all indirect expenses allocated under its separate accounting method to Minnesota, which averaged approximately $130,000 for each of the four years in question, were eliminated, the result would still be taxation of outside income as follows:

Fiscal Year Ending	Minnesota Net Income, Separate Accounting Method	Minnesota Net Income, Separate Accounting Method, Disallowing Outside Expense	Minnesota Net Income, 3-Factor Formula
Sept. 30, 1950	($14,657.46) loss	$115,342.54	$ 98,265.55
Sept. 30, 1951	47,542.45	177,542.45	122,550.53
Sept. 30, 1952	(63,803.79) loss	66,196.21	115,194.26
Sept. 30, 1953	(64,802.09) loss	65,197.91	113,823.04
Total	($95,720.89) loss	$424,279.11	$449,833.38

The statute applicable to the years involved in the suit, M.S.A. 1949, §290.19, subd. 1, read as follows:

> "The taxable net income from a trade or business carried on partly within and partly without this state shall be computed by deducting from the gross income of such business, wherever derived, deduction of the kind permitted by section 290.09 so far as connected with or allocable against the production or receipt of such income. The remaining net income shall be apportioned to Minnesota as follows:

"(1) *If the business consists of the manufacture in Minnesota* or within and without Minnesota of personal property and the sale of said property within and without the state, the remainder shall be apportioned to Minnesota on the basis of the percentage obtained by taking the arithmetical average of the following three percentages:

"(a) The percentage which the sales made within this state and through, from or by offices, agencies, branches or stores within this state is of the total sales wherever made;

"(b) The percentage which the total tangible property, real, personal, and mixed, owned or used by the taxpayer in this state in connection with such trade or business is of the total tangible property real, personal, or mixed, wherever located, owned, or used by the taxpayer in connection with such trade or business; and,

"(c) The percentage which the taxpayer's total pay-rolls paid or incurred in this state or paid in respect to labor performed in this state in connection with such trade or business is of the taxpayer's total pay-rolls paid or incurred in connection with such entire trade or business:

* * * * *

"(2)(a) In all other cases the proportion of such remainder to be assigned to this state shall be that which the sales, gross earnings, or receipts from business operations, in whole or in part, within this state bear to the total sales, gross earnings, or receipts from business operations wherever conducted;

"(b) If the methods prescribed under clause (2)(a) will not properly reflect taxable net income assignable to the state, there shall be used, if practicable and if such use will properly and fairly reflect such income, the arithmetical average of the three percentages set forth in clauses (1)(a), (1)(b), and (1)(c), of this section, or the separate or segregated accounting method." (Italics supplied.)

On appeal plaintiff contends that (1) by its application of the 3-factor formula defendant is taxing income not attributable to plaintiff's activities in Minnesota in contravention of the due-process clause of U.S. Const. Amend. XIV; (2) where plaintiff produced only approximately $200,000 worth of ice cream annually in its Minneapolis plant, all of which it sold to Minnesota customers with the exception of $4,000 worth sold outside the state, and where its sales from other products in Minnesota were in excess of $4,000,000, it was error to determine that under §290.19, subd. 1(1), its business was that of manufacturing so as to compel application of the 3-factor formula referred to in this statute; (3) plaintiff's separate accounting method established that, after deducting from its gross Minnesota income expenses actually incurred in Minnesota, non-Minnesota income was being unlawfully taxed by defendant as a result of his application of the 3-factor formula; and (4) the evidence compels a finding that plaintiff's separate accounting method properly and fairly reflects the portion of plaintiff's taxable income assignable to Minnesota and hence should be applied by defendant in determining plaintiff's taxable income here.

1. Plaintiff does not assign as error or otherwise challenge the court's finding that it is a unitary business, and the evidence above outlined amply supports such a finding. Western Auto Supply Co. v. Commr. of Taxation, 245 Minn. 346, 71 N.W. (2d) 797. Likewise, both plaintiff and defendant concede that the sales formula alone as defined in §290.19, subd. 1(2)(a), is not applicable here. With respect to the 3-factor formula, if the evidence supports a finding that plaintiff's business consists of manufacturing in Minnesota for sale of products within and without the state, the statute requires the commissioner to apply it in determining

net income attributable to Minnesota. If plaintiff is not so engaged, the 3-factor formula is applicable under §290.19, subd. 1(2)(b), if it more fairly reflects the portion of plaintiff's net income attributable to Minnesota than does the sales formula or the separate accounting method.

2. The 3-factor formula[1] as against the separate accounting method has been upheld on numerous occasions,[2] even where the separate accounting method has attributed a lower or in fact no taxable income to the taxing state. Butler Bros. v. McColgan, 315 U.S. 501, 507, 62 S.Ct. 701, 704, 86 L. ed. 991, 996. There the court stated:

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[1]See National Tax Association, Proceedings of 44th Annual Conference 1951, p. 458, where it was stated:

"No method of allocation can precisely determine the exact amount of income attributable either to any given geographic area or to any given part of a series of business transactions culminating in the realization of a profit, and any effort in that direction 'must be more or less arbitrary and fictitious.' However, it was found that the factors of property, payroll, and sales generally reflect all income-producing functions of the business activities covered by this rule. * * *

* * * * *

"* * * approximately half of the states having net income tax laws already provide for the use of a formula consisting of these three factors. The states are: California, Connecticut, Georgia, Idaho, Louisana, Massachusetts, Minnesota, Mississippi, Montana, New York, North Carolina, North Dakota, Oregon, Pennsylvania, Rhode Island, Utah, and Vermont."

[2]Butler Bros. v. McClogan, 315 U.S. 501, 62 S. Ct. 701, 86 L. ed. 991; Edison California Stores, Inc. v. McClogan, 30 Cal. (2d) 472, 183 P. (2d) 16; El Dorado Oil Works v. McClogan, 34 Cal. (2d) 731, 215 P. (2d) 4; Crane Co. v. Carson, 191 Tenn. 353, 234 S.W. (2d) 644, certiorari denied, 340 U.S. 906, 71 S. Ct. 282, 95 L. ed. 655; John Deere Plow Co. v. Franchise Tax Board, 38 Cal. (2d) 214, 238 P. (2d) 569, appeal dismissed, 343 U.S. 939, 72 S. Ct. 1036, 96 L. ed. 1345; State Tax Comm. v. John H. Breck, Inc. 336 Mass. 277, 144 N.E. (2d) 87; Matter of Teague v. Goodrich, 4 App. Div. (2d) 984, 167 N.Y.S. (2d) 820; Gulf Oil Corp. v. Morrison, 120 Vt. 324, 141 A. (2d) 671; Western Auto Supply Co. v. Oklahoma Tax Comm. (Okl.) 328 P. (2d) 414; Western Auto Supply Co. v. Commr. of Taxation, 245 Minn. 346, 71 N.W. (2d) 797.

"It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders."

3. That application of the 3-factor formula may result in some overlapping of measures of net income as between states is not fatal to the honest efforts of a state to determine what would be a fair approximation of the income of a multistate unitary business, State Tax Comm. v. John H. Breck, Inc. 336 Mass. 277, 144 N.E. (2d) 87, and the fact that conditions or costs may vary from state to state in the operation of a unitary business does not affect the propriety of the application of the formula, since the mutual dependence of the interrelated activities in furtherance of the entire business sustains the apportionment process. John Deere Plow Co. v. Franchise Tax Board, 38 Cal. (2d) 214, 238 P. (2d) 569, appeal dismissed, 343 U.S. 939, 72 S. Ct. 1036, 96 L. ed. 1345; Western Auto Supply Co. v. Commr. of Taxation, *supra*. The taxpayer's burden is not satisfied by proof that sepa ate accounting allocates less income to the state. Western Auto Supply Co. v. Commr. of Taxation, *supra*. It must establish that application of the 3-factor formula results in a grossly inequitable allocation of such income. Edison California Stores, Inc. v. McColgan, 30 Cal. (2d) 472, 183 P. (2d) 16.

4 As we construe §290.19, subd. 1(2)(b), a certain discretion is vested in the commissioner to determne whether application of the 3-factor formula fairly and properly reflects the net income attributable to Minnesota of a multistate unitary business, or whether the separate accounting method reaches this objective more accurately. Western Auto Supply Co. v. Commr. of Taxation, 245 Minn. 346, 358, 71 N.W. (2d) 797, 805. To upset his choice of methods here, plaintiff must establish that its business is not that of manufacturing; and that application of the 3-factor formula under §290.19, subd. 1(2)(b), has resulted in taxing such a substantial part of its income not attributable to Minnesota as to make the allocation grossly inequitable and invalid under the due-process clause of U.S. Const. Amend. XIV. On the other hand, if the evidence fairly supports the finding that application of the 3-factor formula has resulted in a reasonable reflection of its net income fairly apportionable to Minnesota, then even though this method may not have produced the most accurate or precise results, we have no choice but to approve it.

Under the principle established in Butler Bros. v. McColgan, 315 U.S. 501, 62 S. Ct. 701, 86 L. ed. 991, and adhered to in Western Auto Supply Co. v. Commr. of Taxation, 24 Minn. 346, 71 N.W. (2d) 797, and Crane Co. v. Carson, 191 Tenn. 353, 234 S.W. (2d) 644, certiorari denied, 340 U.S. 906, 71 S. Ct. 282, 95 L. ed. 655, we are of the opinion that the commissioner's determination to apply the 3-factor formula should be approved. While plaintiff's separate accounting method for the years in question has disclosed substantially less net income attributable to Minnesota than does application of the 3-factor formula, this is not a vital factor in determining whether the latter procedure

has resulted in a fair reflection of plaintiff's net income taxable in Minnesota. Thus in Butler Bros. v. McColgan, *supra*, under the taxpayer's separate accounting method, a loss of $82,851 in California was indicated, while application of the 3-factor formula determined that $93,551.52 of the taxpayer's net income was apportionable to California—a difference of $176,402.52 for the year involved. In sustaining application of the 3-factor formula, the United States Supreme Court disregarded this as controlling on the theory that separate accounting practices vary according to the problem at hand and that though useful as a business aid they may not fit requirements when a state seeks to tax values created by business within its borders.

Likewise, in Western Auto Supply Co. v. Commr. of Taxation, *supra*, the taxpayer's separate accounting method for the year in question showed a net taxable income of $20,996.57 apportionable to Minnesota while the 3-factor formula attributed $47,836.48, more than double the taxpayer's figure. There in answer to the claim that such results established that the state was taxing income not properly assignable to it, we said (245 Minn. 359, 71 N.W. [2d] 806):

> "While the taxpayer's separate accounting method may be quite suitable for taxpayer's business purposes, it nevertheless seems definitely inadequate for the purpose of attributing to Minnesota with a fair degree of accuracy that portion of the taxpayer's income which was earned by its Minnesota operations * * *.
>
> "* * * It must be recognized that even the so-called separate accounting system cannot be kept with exactness."

And so also in Crane Co. v. Carson, *supra*, where the taxpayer's separate accounting method for a 3-year period

indicated enormous losses, the court upheld the tax commissioner's application of the 3-factor formula which established that $88,260.25 in franchise and excise taxes were due on taxpayer's net income attributable to the state for the years involved. Basically, approval of the application of the 3-factor formula rests upon a conclusion expressed in most of the cited cases that in multistate unitary operations the separate accounting method is inherently incapable of accurat y allocating income. Based upon the authorities cited a for the reasons expressed, we must uphold the commissioner's election to apply the 3-factor formula here. Because of this conclusion, it is not necessary to determine whether plaintiff, because of its production in Minneapolis of ice cream for sale within and without the state, is in the business of manufacturing within the concept of §290.19, subd. 1(1)(a, b, c).

Affirmed.

MR. JUSTICE LOEVINGER, not having been a member of the court at the time of the argument and submission, took no part in the consideration or decision of this case.

STATE OF MINNESOTA
SUPREME COURT

Walgreen Company,

Appellant,

vs.

Commissioner of Taxation,

Respondent

Pursuant to an order of Court heretofore duly made and entered in this cause it is determined and adjudged that the judgment of the Court below, herein appealed from, to-wit, of the District Court within and for the County of Ramsey be and the same hereby is in all things affirmed.

And it is further determined and adjudged that respondent herein, do have and recover of appellant herein the sum and amount of Two Hundred Sixteen and 25/100 Dollars, ($216.25) costs and disbursements in this cause in this Court, and that execution may be issued for the enforcement thereof.

Dated and signed September 27, 1960.

BY THE COURT

Attest: Mae Sherman, Clerk

STATEMENT FOR JUDGMENT

Statutory Costs $25.00; Printer $191.25; Total $216.25

Satisfaction of Judgment Filed

Therefore the above judgment is duly satisfied in full and discharged of record.

APPENDIX B

(Title of Cause)

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER FOR JUDGMENT

The above entitled action came on to be heard before the Court, without a jury, in the Courthouse in the City of Saint Paul, on May 23, 1958, Messrs. Irving Clark and Timothy J. Halloran, and Doherty, Rumble and Butler, appeared as attorneys for the plaintiff, the Walgreen Company, and Mr. Arthur C. Roemer, Special Assistant Attorney General, appeared on behalf of the defendant, the Commissioner of Taxation.

Having heard the testimony produced by both parties, having heard the arguments of the respective counsel, having read the briefs filed by the respective counsel, and having duly considered the matter, the Court makes the following findings of fact, conclusions of law and order for judgment.

FINDINGS OF FACT

1. That plaintiff is an Illinois corporation qualified to do business in Minnesota, having its principal office in Chicago, Illinois.

2. That plaintiff is engaged in operating retail drug stores in Minnesota and in eight other states.

3. That during the period involved, plaintiff operated fourteen to fifteen stores in Minnesota, and an average of one hundred ninety-one stores outside of Minnesota.

4. That the territory served by the plaintiff was divided into districts, supervised by district managers. That these district managers are hired by the Chicago office. That one of the districts consisted of all of plaintiff's stores lo-

cated in Minnesota and in addition the stores located in Eau Claire, Wisconsin, and Aberdeen, South Dakota.

5. That each store is managed by a store manager who is hired by and supervised by the district manager.

6. That in addition to the company-owned stores, there are also a substantial number of agency stores, located both within and without Minnesota, who are franchised by the Walgreen Company, permitted to use the Walgreen Company name, and which purchase substantial amounts of merchandise from the Walgreen Company. That none of that income has been assigned to Minnesota.

7. That plaintiff maintains a central warehouse in Chicago in addition to warehouses in Minneapolis and Denver, in which merchandise purchased is stored until ultimately shipped to a retail or agency store.

8. That store policies and personnel policies are set up by the home office in Chicago, but are subject to adjustment by the district manager to meet local conditions. That district managers are under the constant supervision of the plaintiff's vice-president and other home office personnel who observe individual store operations and make recommendations for improvement.

9. That meetings of district managers and store managers are held periodically.

10. That a training program is conducted by the home office for district managers.

11. That plaintiff maintains a central real estate department in Chicago with negotiators who work with the district manager and negotiate leases and other arrangements for new locations.

12. That plaintiff manufactures ice cream in Minnesota for distribution in Minnesota and South Dakota.

13. That the accounting for all the stores is centralized in the Chicago home office. Daily reports are submitted by the store managers through the district manager to the Chicago office, where records of sales, purchases, receipts and disbursements are kept. Reports containing statistics about individual store operations are periodically prepared by the Chicago office.

14. A substantial part of the purchasing is centralized. That store managers purchase substantial merchandise locally but also purchase much merchandise from the central warehouse. That the smaller stores do more buying from the company warehouse.

15. That the Chicago office maintains an advertising department that supervises and directs the advertising program of the stores. That most of the advertising is done locally, from maps prepared by the Chicago office, and reviewed by the district manager.

16. That the Walgreen Company home office in Chicago is also the main office of other subsidiaries, operating in most of the other states.

17. That the plaintiff is a unitary business, its various parts being interdependent and of mutual benefit.

18. That plaintiff's entire system benefits from the centralized purchasing, management, buying and other centralized functions.

19. That the plaintiff and the defendant both concede that the sales formula alone does not result in a proper reflection of Minnesota taxable net income.

20. That plaintiff reported net income assignable to Minnesota by the separate accounting method, charging the direct expenses incurred by each store to the store and allocating purchases discount, overhead costs, warehousing costs, and advertising expenses.

21. That the Commissioner of Taxation determined plaintiff's net income assignable to Minnesota using the arithmetic three-factor formula outlined in Minnesota Statutes, Section 290.19, which assigns to Minnesota that part of its total net income which its property, payroll and sales within Minnesota bears to its total property, payroll and sales.

22. That, in many of the earlier years, this resulted in a refund to the plaintiff.

23. That in the years at issue (fiscal years ending September 30, 1950, September 30, 1951, September 30, 1952, and September 30, 1953) the Commissioner's determination resulted in additional taxes aggregating $13,026.73, with interest of $2,471.70, totaling $15,498.43, being assessed which the plaintiff paid. That on February 23, 1957, timely claims for refund for this additional tax were filed on which no action had been taken on the date of commencement of this action.

24. That the figures used in the Commissioner's determination of income under the three-factor formula were not disputed.

25. That the plaintiff's separate accounting does not properly assign to Minnesota the correct amount of net income attributable to Minnesota.

26. That the Commissioner's formula reasonably reflects the net income of the plaintiff assignable to Minnesota.

27. That the factors used by the defendant, property, payroll and sales, do, in sufficient measure, give weight to the different factors responsible for the earning of the income of the plaintiff.

CONCLUSIONS OF LAW

1. That the defendant, the Commissioner of Taxation, is not indebted to the plaintiff, the Walgreen Company.

2. That the Commissioner of Taxation, the defendant herein, is entitled to judgment against the plaintiff.

ORDER FOR JUDGMENT

Let judgment be entered accordingly, with costs and disbursements to the defendant.

Dated this 30th day of September, 1958.

Stay 40 days.

ALBIN S. PEARSON
Judge of District Court

(Title of Cause)

ORDER FOR AMENDED FINDINGS OF FACT

The plaintiff in the above entitled action, having moved this Court for amended Findings of Fact, Conclusions of Law, and Order for Judgment, the matter was placed on for hearing before this Court in Chambers on November 26, 1958, at 9:00 a.m., Doherty, Rumble and Butler, by Irving Clark and Timothy J. Halloran, appearing on behalf of the plaintiff, and Miles Lord, Attorney General, by Arthur C. Roemer, Special Assistant Attorney General, appearing on behalf of the defendant.

The Court, having heard the arguments of counsel and being apprised in the premises, the motion is hereby in all respects denied except as hereinafter ordered.

It is hereby ordered that the Findings of Fact, numbered 6, 12, 15, 20, 22 and 23, in the above entitled matter be amended to read as follows:

6. That in addition to the company-owned stores, there are also a substantial number of agency stores, located both within and without Minnesota, which are franchised by the Walgreen Company, permitted to use the Walgreen Company name, and which purchase substantial amounts of merchandise from the Walgreen Company. That none of that income has been assigned to Minnesota either by the plaintiff or the defendant.

12. That plaintiff manufactures ice cream in Minnesota for distribution in Minnesota and Wisconsin.

15. That the Chicago office maintains an advertising department that supervises and directs the advertising program of the stores. That all advertising is done through newspapers in the cities in which plantiff operates its stores from mats prepared by the Chicago office which are reviewed and subject to alteration by the district manager.

20. That plaintiff reported net income assignable to Minnesota by the separate accounting method, charging the direct expenses incurred by each store to the store and allocating purchases discount, overhead costs, warehousing costs, and home office advertising expenses.

22. That in some of the years prior to the years in issue, the Commissioner's use of the three-factor formula resulted in a refund of tax to the plaintiff, and in some of said years the Commissioner's use of the three-factor formula resulted in an additional tax to be paid by the plaintiff.

23. That in the years at issue (fiscal years ending September 30, 1950, September 30, 1951, September 30, 1952, and September 30, 1953) the Commissioner's determination re-

sulted in additional taxes aggregating $13,026.73, with interest of $2,471.70, totaling $15,498.43, being assessed which the plaintiff paid. That on February 23, 1957, and May 3, 1957, timely claims for refund for this additional tax were filed on which no action had been taken on the date of commencement of this action.

Dated at St. Paul, Minnesota, this 10th day of December, 1958.

ALBIN S. PEARSON
Judge of District Court

(Title of Cause)

JUDGMENT

Pursuant to the Findings of Fact, Conclusions of Law, and Order for Judgment—Pearson, J., dated and filed on the 30th day of September, 1958, and Order for Amended Findings of Fact—Pearson, J., dated and filed on the 10th day of December, 1958.

Now, on motion of Miles Lord and Arthur C. Roemer, said attorneys, it is hereby adjudged that the plaintiff herein recover nothing of said defendant The Commissioner of Taxation, and that said defendant have judgment in his favor against the Walgreen Company, an Illinois corporation, plaintiff herein, for the sum of no dollars damages with Fourteen and No/100 Dollars costs and disbursements, in all amounting to $14.00.

Signed this 11th day of February, A. D. 1959.

E. J. FITZGERALD
Clerk
By F. L. WESTON
Deputy Clerk

APPENDIX C

290.19 NET INCOME TO BE ALLOCATED. Subdivision 1. Computation when business conducted partly within state; apportionment. The taxable net income from a trade or business carried on partly within and partly without this state shall be computed by deducting from the gross income of such business, wherever derived, deduction of the kind permitted by section 290.09 so far as connected with or allocable against the production or receipt of such income. The remaining net income shall be apportioned to Minnesota as follows:

(1) If the business consists of the manufacture in Minnesota or within and without Minnesota of personal property and the sale of said property within and without the state, the remainder shall be apportioned to Minnesota on the basis of the percentage obtained by taking the arithmetical average of the following three percentages:

(a) The percentage which the sales made within this state and through, from or by offices, agencies, branches or stores within this state is of the total sales wherever made;

(b) The percentage which the total tangible property, real, personal, and mixed, owned or used by the taxpayer in this state in connection with such trade or business is of the total tangible property real, personal, or mixed, wherever located, owned, or used by the taxpayer in connection with such trade or business; and,

(c) The percentage which the taxpayer's total pay-rolls paid or incurred in this state or paid in respect to labor performed in this state in connection with such trade or business is of the taxpayer's total pay-rolls paid or incurred in connection with such entire trade or business;

(d) The percentage of such remainder to be assigned to this state shall not be in excess of the sum of the following percentages: 70 per cent of the percentage determined under clause (1) (a), 15 per cent of the percentage determined under clause (1) (b), and 15 per cent of the percentage determined under clause (1) (c);

(2) (a) In all other cases the proportion of such remainder to be assigned to this state shall be that which the sales, gross earnings, or receipts from business operations, in whole or in part, within this state bear to the total sales, gross earnings, or receipts from business operations wherever conducted;

(b) If the methods prescribed under clause 2) (a) will not properly reflect taxable net income assignable to the state, there shall be used, if practicable and if such use will properly and fairly reflect such income, the arithmetical average of the three percentages set forth in clauses (1) (a), (1) (b), and (1) (c), of this section, or the separate or segregated accounting method;

(3) The sales, pay-rolls, earnings, and receipts referred to in this section shall be those for the taxable year in respect of which the tax is being computed. The property referred to in this section shall be the average of the property owned or used by the taxpayer during the taxable year in respect of which the tax is being computed;

(4) For the purposes of this section, in determining the amount of sales made within Minnesota, there shall be excluded therefrom sales negotiated or effected in behalf of the taxpayer by agents or agencies chiefly situated at, connected with, or sent out from premises for the transaction of business owned or rented by the taxpayer or by his agents or agencies outside the state and sales otherwise determined

by the commissioner to be attributable to the business conducted on such premises. If the commissioner finds that the taxpayer maintains an office, warehouse or other places of business outside the state for the purpose of reducing its tax under this section it shall in determinng the amount of taxable net income include therein the proceeds of sales attributed by the taxpayer to the business conducted at such place outside the state.

Subd. 2. Application of methods. The methods prescribed by subdivision 1 shall apply wherever and in so far as the business carried on within this state is an integral part of a business carried on both within and without this state. Subd. 3. Application of sections 290.17 and 290.18.

Nothing in this section shall prevent the application of sections 290.17 and 290.18 to that portion of a taxpayer's income which is not from a trade or business carried on partly in and partly without this state.

APPENDIX D

ARTICLE 19-3.—*Apportionment of Net Income Under Section 290.19 subd. 1(2)*

If the business consists of the manufacture wholly without Minnesota of personal property and the sale of said property within and without the state and in all other cases where the taxpayer does not manufacture in Minnesota, the ratio shall be that which the sales, gross earnings, or receipts from business operations in whole or in part within this State bear to the total sales, gross earnings, or receipts from business operations wherever conducted.

When it has been determined (1) that the use of single factor formula described above does not properly and fairly reflect taxable net income assignable to this State; and (2) that the use of the arithmetical average of the sales, property, and payroll ratios or the use of the separate accounting method will properly and fairly reflect taxable net income assignable to this State; and (3) that the use of either of these alternate methods is practicable, the Commissioner may permit or require the use of such alternate method. In case the separate or segregated accounting method is permitted or required, Schedule N of Form 1-5 must be completed and made a part of the return.

APPENDIX E

State	*Statutory Citation*
Alabama	Title 51, Section 398, Code of Alabama 1940
Arizona	A.R.S. Sec. 43-135 (g)
Arkansas	Ark. Stat. (1947), Section 84-2020 (1) (2)
Colorado	C.R.S. 1953, 138-1-28
Connecticut	Conn. Gen. Stat. Section 12-221 (1958)
Delaware	30 Del. C. Section 1903 (c)
District of Columbia	D. C. Code 1951, Section 47-1580 (a) and D. C. Income Tax Regulations, Section 10-2 (c) (4)
Georgia	Title 92, Section 3114, Code of Georgia 1933
Idaho	Idaho Code 1947 § 63-3027 (e) (1) (Cum. Supp. 1959)
Iowa	Section 422.33, Code of Iowa 1958 and Section 22.33 (2)-2 of Iowa Income Tax Regulations
Kansas	G.S. 1949, 79-3217
Louisiana	Louisiana Revised Statutes 1950, Title 47, Section 244 (Cum. Supp. 1958)

Massachusetts	General Laws, c. 63, §42 (Cum. Supp. 1959)
Mississippi	Section 9220-12 (1) (c), Mississippi Code of 1942 (Cum. Supp. 1958) and Section 247 of Mississippi Income Tax Regulations
Missouri	R.S. Mo. 1949, Sec. 143.080
New Mexico	Sec. 72-15-32 (b) N.M.S.A. 1953 Comp.
North Carolina	G. S. 105-134 (6) (g) Recomp. 1950-1955) (Cum. Supp. 1959)
North Dakota	Section 57-3814.2, North Dakota Revised Code of 1943
South Carolina	Section 65-279.14, Code of Laws of South Carolina 1952 (Cum. Supp. 1959)
Tennessee	67-2711 Tennessee Code Annotated
Utah	Utah Code Ann. 1953, Sec. 59-13-20 (8) (Cum. Supp. 1959)
Wisconsin	Section 71.07 (2) Wisconsin Statutes (1959)